

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations

Department of the Treasury

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Release Date: 4/24/2015
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Date:
05/16/2013
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:
December 31, 20XX
December 31, 20XX
Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:
Manager's name/ID number:

Manager's contact number:

Response due date:

Certified Mail – Return Receipt Requested

Dear :

Why you are receiving this letter

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

What you need to do if you agree

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

If we don't hear from you

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal

standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

Effect of revocation status

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

What you need to do if you disagree with the proposed revocation

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

Contacting the Taxpayer Advocate Office is a taxpayer right

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service
Office of the Taxpayer Advocate

For additional information

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

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| Form 886-A (Rev. January 1994) | EXPLANATIONS OF ITEMS | Schedule number or exhibit |
| Name of taxpayer ORG | Tax Identification Number | Years/Periods ended 12/31/20XX 12/31/20XX |

Issues

Issue 1. Whether the ORG operated primarily for private benefit during the years under examination, thus failing the operational test of Treas. Reg. 1-501(c)(3)-1(c)(1).

Issue 2. Whether the ORG failed to operate exclusively for exempt purposes as required by Internal Revenue Code §501(c)(3) during the years under examination, thus failing the operational test of Treas. Reg. 1-501(c)(3)-1(c)(1).

Facts

Background Information

According to the Corporation Commission's website, the ORG was incorporated in the state State on October 16, 20XX.

On July 18, 20XX, the Internal Revenue Service issued Letter 1045 notifying the ORG of its exempt status under I.R.C. § 501(c)(3). Per the current Internal Revenue Service records, the ORG is recognized as tax exempt under IRC § 501(c)(3) and its foundation status is IRC § 509(a)(2). The effective date of the exempt status is October 12, 20XX.

Beginning December 4, 20XX, an examination was conducted on the books, records, and activities for the tax year ending December 31, 20XX. On December 20, 20XX the examination was expanded to included tax year ending December 31, 20XX.

Condominium Complex is a condominium complex with 219 condominiums. Condominium Complex is managed by a Home Owners Association with the same name. This entity will be referred to as the Home Owners Association. The Home Owners Association manages the property. The residents own their individual condominiums and a proportionate share of the common areas of the complex. The Home Owners Association, in addition to managing the property, provides senior services for the residents. Each resident pays a monthly fee to the Home Owners Association for the services they provide. However, the monthly fee does not include money for capital improvements to the condominium complex. To resolve this problem the Home Owners Association has a fund called the "Fund". Residents can make contributions to Fund for capital improvements, these contributions are not tax deductible. This makes raising money for capital improvements difficult.

In 20XX, Individual-1, a resident of the Home Owners Association came up with the idea to create an exempt organization so residents could contribute to the projects of

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the Home Owners Association and receive a tax deduction. Thus, the ORG (the Organization) was formed and received its tax exempt status effective October 12, 20XX.

The ORG (the Organization) has two paragraphs explaining its exempt purpose in its Articles of Incorporation, Bylaws, and its Application for Recognition of Exemption (Form 1023), the paragraphs follow:

"Said corporation is organized exclusively for charitable, religious, educational and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or corresponding sections of any future federal tax code."

"The ORG shall accept and hold all kinds of property received as gifts, bequests, legacies, donations or otherwise to be beneficiary, or trustees under testamentary or inter vivos trusts, to manage and invest, accumulate such property or the income there from for the benefit of all resident owners of Condominium Complex Condominiums other than current operating expenses."

The mission statement on the Form 990 for the year ending December 31, 20XX, confirms the second of the two paragraphs and states the Organization's mission is "to benefit all resident owners of Condominium Complex condominiums, for projects outside their operating budget, related to health, wellness, safety, and education."

Initial Interview

An initial interview was conducted with the Organization's President, a Board Member, and the Organization's Accountant on December 4, 20XX. The following discussion is a summary of some of the questions and answers that were exchanged by the parties during the initial interview:

1. Tell me about your organization's history and its activities?

The purpose is to provide health, safety, and education for the senior residents of Condominium Complex.

The Organization was formed so the residents could contribute to the projects of the Home Owners Association (HOA), and receive a tax deduction. The founder was Individual-1. He pushed very hard to achieve this. The projects are available only to residents and their guests.

The HOA is an State Non-profit association.

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The property is owned by the residents and each owner also owns their proportionate share of the common areas.

The money raised or contributed to the Organization goes for projects needed by the HOA. The HOA board is composed of residents of Condominium Complex. That is, money is paid to the HOA (not a 501(c)(3)) for the improvements or projects.

2. Who opens and/or reviews the mail?

Administrative Assistant (administrative assistant to Employee-1 and an employee of the HOA) opens and reviews the mail.

Mostly residents donate to the Organization and sometimes a family member will donate in memory of a past resident.

The residents have been informed when making donations to put them in the mail slot. The mail slot is in the door that leads to HOA's administrative offices. This is just inside the front entrance.

Tour of Facility

The Organization has no independent location. The President of the Organization works from her condominium, and Board meetings are conducted in common areas at the condominium complex, i.e. the Home Owners Association.

On December 7, 20XX the Agent toured the condominium complex with the general manager of the Home Owners Association (she is also a Board Member of the Organization). The Agent saw several of the item purchase by the Home Owners Association with the Organization funds, including the auditorium partitions, a flat screen television in the gym, and the pool which was converted to solar heating with the Organization's grant/donation to the Home Owners Association.

Additionally, the complex has security staff. There are only two vehicle entrances from public streets. Entry is limited to the residents and their guests. There is fence around the entire community including the side of the property that borders the lake.

The Board, Board Meetings, and Minutes

The Board meets monthly (the first Thursday of every month), and is composed of nine directors plus the General Manager of Condominium Complex (i.e. the Home Owners Association). Article 3, Section 2 of the Organization's Bylaws states, "All members (of the board of directors) shall be owner/residents of the Condominium Complex." (i.e.

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owner/residents of the Home Owners Association). Also, the Board of Directors replaces vacancies on the Board. The following is a summary of some Board Meeting minutes.

1. February 4, 20XX – President, President of the Home Owners Association spoke at the Board Meeting. The minutes reflect he emphasized the Foundation's (i.e. the Organization) priority must be funding (i.e. raising money), and without funding in hand or en-route, the Home Owners Association is unable to move ahead with plans for projects for the community (i.e. Home Owners Association).
2. July 1, 20XX – The minutes reflect a lengthy discussion was held on replacing the doors to the swimming pool area at a cost of \$0, and that the Home Owners Association has approved the installation of the doors.
3. August 5, 20XX – The minutes reflect:
 - a. A homeowner (i.e. resident) donated a juke box.
 - b. A homeowner (i.e. resident) donated an AED defibrillator, and the Home Owners Association approved its installation.
 - c. A homeowner (i.e. resident) donated yellow umbrellas for the pool area. The purchase of up to eight umbrellas was approved by the Home Owners Association.
4. November 4, 20XX – The minutes reflect, funding for pool loungers was given by two residents, however, the Organization wanted approval of the Home Owners Association prior to purchasing the pool loungers.
5. February 3, 20XX – The minutes reflect the findings of the Ad Hoc committee. The committee estimated the costs associated with accepting a condominium as a donation. They found the fees would be approximately \$0 to \$0 for the property transfer, and \$0 to \$0 per month after the property transfer. The Organization set a goal to raise \$0 to cover the costs of the condominium donation. The \$0 was solicited via internal condominium complex advertising.
6. June 2, 20XX – The minutes reflect the Board's concern with paying the costs associated the condominium until it is sold, if the condominium is accepted as a donation.
7. July 7, 20XX – The minutes reflect the Organization will ask residents for a loan to cover the cost of the expenses of the condominium.

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Publications

In the initial interview it was stated the Organization does no advertising. However the Organization did post flyers at the condominium complex. The Organization retained copies of all posted flyers. The Organization provided these flyers to the Agent during the examination. The flyers would solicit donations by suggesting donations come directly from Individual Retirement Accounts, or made via will, trust, or beneficiary deed for condominiums (Exhibit 1). A flyer posted stated total donations from August 28, 20XX to December 15, 20XX to the Home Owners Association totaled \$0, and included "Solar for Pool & Spa \$0, Automatic Doors to Pool Area \$0, Room Dividers for Auditorium \$0 (Exhibit 2).

Analysis of the Organization's Expenses

The key year of the examination was 20XX, and during the course of the examination the Agent tested the expenses for the key year and found they reflect what appears on the tax return. In response to the Agent request for documentation of Organization's expenses for 20XX and 20XX the Organization provided their Purchase Order Log from 20XX through 20XX, an exact copy follows.

Purchase Order Log 20XX - 20XX

- LOG DELETED -

Purchase Order Log – 20XX

- LOG DELETED -

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From the above copy of the Organization's purchase order log, \$0 was paid directly to the Home Owners Association, for things like solar heating for the pool (\$0), room dividers for the auditorium (\$0), and an automatic door opener (\$0). In order to accomplish these tasks for the Home Owners Association, the Organization spent \$0 on administrative expenses such as insurance (\$0) and settlement costs for a donated condominium (\$0). Also, \$0 was paid directly to employees of the Home Owners Association for tuition reimbursement.

Law

Tax Exemption

Generally, an organization that is described in I.R.C. § 501(c)(3) is exempt from income tax. See I.R.C. §§ 501(a). These organizations include corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. See I.R.C. § 501(c)(3).

In order to be exempt as an organization described in I.R.C. § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt. See Treas. Reg. § 1.501(c)(3)-1(a)(1).

An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in I.R.C. § 501(c)(3). See Treas. Reg. § 1.501(c)(3)-1(c)(1). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

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The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. See *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279 (1945). The operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private benefit rather than public interests. See Treas. Reg. §1.501(c)(3)-1(c)(2).

An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than private interest. See Treas. Reg. § 1.501(c)(3)-1(d)(ii). Thus, an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or creator's family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

The presence of a single substantial non-exempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. See *Better Bus. Bureau v. United States*, 326 U.S. 279.(1945); *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053, 1065 (1989). See also, *Old Dominion Box Co., Inc. v. United States*, 477 F2d. 340 (4th Cir. 1973), *cert. denied*, 413 US 910 (1973) (operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. *Am .Campaign Acad. v. Commissioner, supra*, at 1065 -1066.

A nonprofit organization with membership limited to the residents and business operators within a city block and formed to preserve and beautify the public areas in the block, thereby benefiting the community as a whole as well as enhancing the members' property rights, will not qualify for exemption under section 501(c)(3). Rev. Rul. 75-286.

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Government's Position

Issue 1. It is the government's position that Organization operated primarily for private benefit during the years under examination. More specifically, the Home Owners Association received private benefit.

The operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private benefit rather than public interests. See Treas. Reg. §1.501(c)(3)-1(c)(2).

Treas. Reg. § 1.501(c)(3)-1(d)(ii), an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, or creator's family, shareholders of the organization, or persons controlled, directly or indirectly, by such interests.

Clearly stated on the Organization's Form 990 for the period ending December 31, 20XX, is the Organization's mission, "to benefit all resident owners of Condominium Complex condominiums, for projects outside their operating budget, related to health, wellness, safety, and education." In the initial interview it was stated the reason for the creation of the Organization was "so the residents could contribute to the projects of the Home Owners Association (HOA), and receive a tax deduction." The private benefit is two fold, first the tax deduction for the residents of the Home Owners Association for their contributions and then capital improvements to property of the residents of the Home Owners Association.

From the Organization's Purchase Order Log, expenses of \$0 have been paid. The Home Owners Association directly received \$0. \$0 went for administrative expenses in support of the Organization non-exempt purposes. Employees of the Home Owners Association received \$0. All expenses paid were for the Home Owners Association, either directly or indirectly.

In Rev. Rul. 75-286 advice was requested as to whether a nonprofit organization qualified for exemption from Federal income tax under IRC § 501(c)(3). Membership was limited to the residents and business operators within a city block and was formed to preserve and beautify the public areas of the block, thus benefiting the community as a whole as well as enhancing the members' property rights

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The activities of the organization in Rev. Rul. 75-286 were to pay the city government to plant trees on public property within the block, organize residents to pick-up litter and refuse in the public streets and on public sidewalks within the block, and encouraging residents to take an active part in beautifying the block by placing shrubbery in the public area within the block.

Much of the public area improved by the organization in Rev. Rul. 75-286 is the public roadway lying between the sidewalk and the street in front of private property owned by members of the organization. Also, membership was restricted to residents of the block and those owning property or businesses in the block. The organization's support was derived from receipts from block parties and voluntary contributions from members.

In Rev. Rul. 75-286 it was determined the organization did not qualify for exemption from Federal income tax under section 501(c)(3) for the following reasons:

1. By enhancing the value of the roadway sections abutted by property of the members, the organization enhanced the value of its members property rights.
2. The restricted nature of membership.
3. The limited area for improvements (i.e. a block)

Rev. Rul. 75-286 found these factors, "indicate that the organization is organized and operated to serve the private interests of its members within the meaning of section 1.501(c)(3)-1(d)(ii) of the regulations." The Revenue Ruling further states the organization, "is not organized and operated exclusively for charitable purposes. Therefore, it does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code."

Rev. Rul. 75-286 is on point with the Organization under examination. The following are similarities of the Organization under exam and the organization in Rev. Rul. 75-286.

1. In the Revenue Ruling the members of the organization wanted to improve/beautify the roadway abutting their property. It was determined this enhanced the organization's members property rights. The Organization under examination raises money to fund projects (mostly capital improvements) of the Home Owners Association thus improving residents property rights.

Also, as a note the Revenue Ruling organization was improving public property and giving up ownership to the improvements. The Organization under exam has given money to the Home Owners Association, the Home

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Owners Association makes capital improvements to private property, and these improvements are still owned by the Home Owners Association.

2. Membership in the Revenue Ruling organization was limited to residents and businesses within the block, for the Organization under exam, a requirement to be a board member is ownership/residency in the Home Owners Association. These are the only members of the Organization, and the Organization's board is self perpetuating, they fill all vacancies on the Board. So, membership in the Organization under exam is even more limited than the organization in the Revenue Ruling.
3. In the Revenue Ruling the organization made block improvement, these would be accessible to the public on public roads going through the block, and this area (a block) was considered limited. The Organization under exam is fully fenced in and has no public roads within the Home Owners Association. So, here the area for the Organization under exam is even more limited than the organization in the Revenue Ruling.
4. The Organization under exam receives most of its funding from the residents of the Home Owners Association. This is similar to the Revenue Ruling organization receiving funds from its members and block parties.

So, it is for the above reasons, the Organization was organized and operates to serve the private benefit and fails the operational test.

Issue 2. It is the government's position that the Organization failed to operate exclusively for exempt purposes during the years under examination. In particular, the Organization is not operated for a charitable purpose under IRC § 501(c)(3).

Per Treas. Reg. § 1.501(c)(3)-1(d)(ii), an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than private interest, and per Issue 1 above it was established the Organization was operating for a private interest and not for the public.

The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. See *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279 (1945).

Here there is no evidence the Organization was conducting a charitable activity listed under IRC § 501(c)(3), some examples are; religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals. Treas. Reg. § 1.501(c)(3)-1(c)(1) states, an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more exempt purposes.

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Essentially, the Organization has two activities, one is to raise money and the second is to spend the money raised on capital improvements for the Home Owners Association.

As was stated in the initial interview, the reason for forming the Organization was, "so the residents could contribute to the projects of the Home Owners Association (HOA), and receive a tax deduction." This statement was confirmed on the Organization Form 990, for the period ending December 31, 20XX, in the Organization's mission statement. The Organization's mission is "to benefit all resident owners of Condominium Complex condominiums, for projects outside their operating budget, related to health, wellness, safety, and education."

The Board Minutes document the Board's focus on raising money for capital improvements for the Home Owners Association. The President of the Home Owners Association spoke at a board meeting saying the primary concern of the Organization should be raising money, so capital improvement for the Home Owners Association can be accomplished. The Board Minutes show the Board's focus on setting goals to raise money from the residents to pay for costs to maintain a donated condominium and replace the doors to the pool area.

Further supporting this position, are the flyers posted by the Organization, requesting donations from Individual Retirement Accounts, trusts, and wills. Flyers were also posted detailing \$ of funds going to the Home Owners Association for various projects, like solar heating for the pool and the replacement of the doors to the pool area.

In support of this position is the Organization's Purchase Order Log which shows since 20XX expenses of \$0 have been paid and of that \$0 has gone directly to the Home Owners Association, \$0 has been paid for administrative expenses in support of the Organization non-exempt purposes, and \$0 has gone to the employees of the Home Owners Association.

The Organization has two activities, one is to raise money and the second is to spend the money raised on capital improvements for the Home Owners Association. These activities are the primary activities of the Organization, they do not meet the requirements of exempt purpose under IRC § 501(c)(3), and because of these two primary activities the Organization is operated only for a non-exempt purpose, and fails the operational test.

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Taxpayer's Position

The Taxpayer has indicated agreement with the government's position as stated in this report.

Conclusion

The Organization does not qualify for exemption under IRC § 501(c)(3), and therefore its tax exempt status should be revoked for failing the operational test of Treas. Reg. 1-501(c)(3)-1(c)(1) for the following reasons:

1. The Organization operated for private benefit rather than public interest during all years under examination
2. The Organization does not operate exclusively for exempt purposes as required by I.R.C. § 501(c)(3).

The revocation should be effective January 1, 20XX. Form 1120, U.S. Corporation Income Tax Return should be filed for 20XX and each year thereafter as long as it remains subject to Federal Income Tax. If the proposed revocation becomes final, appropriate State officials will be notified of such actions in accordance with IRC § 6104(c).